# Canada Southern Petroleum Ltd.

# Annual Report 1979

## Directors and Executive Officers

**John W. Buckley,** *Chairman of the Board, President and Director*
President and a Director of United Canso Oil & Gas Ltd. and Pantepec International, Inc.; and a Director of Coastal Caribbean Oils & Minerals, Ltd., and Pancoastal, Inc.

**M. A. Reasoner,** *Technical Advisor to the Chairman of the Board and Director*
Associated with Canada Southern Petroleum Ltd. since its formation, he served as Vice President and General Manager until 1971.

**John W. Bush,** *Director*
Vice President of Coastal Petroleum Company, and served as Chairman of the Interstate Commerce Commission and special advisor to the United States Senate Commerce Committee.

**Thomas W. Donlon,** *Director*
Director of Pantepec International, Inc. and Pancoastal, Inc., and until his retirement in 1967 was Vice President in charge of foreign production for American Overseas Petroleum, Ltd.

**Benjamin W. Heath,** *Director*
President and a Director of Coastal Caribbean Oils & Minerals, Ltd. and Magellan Petroleum Corporation; Chairman and a Director of Magellan Petroleum Australia Limited, and a Director of United Canso Oil & Gas Ltd.

**Charles J. Horne,** *Vice President*
Associated with Canada Southern Petroleum Ltd. since 1950, was elected Vice President in July 1976.

**Arthur B. O'Donnell,** *Vice President*
President and a Director of Pancoastal, Inc. and a Vice President of Coastal Caribbean Oils & Minerals, Ltd., Magellan Petroleum Corporation, Pantepec International, Inc., and United Canso Oil & Gas Ltd.

**K. E. Noble,** *Treasurer*
Associated with Canada Southern Petroleum Ltd. since 1955, was elected Treasurer in September 1975.

**Paul A. Giesinger,** *Secretary*
Associated with Canada Southern Petroleum Ltd. since 1954, was elected Secretary in February 1977.

## Auditors

Arthur Young, Clarkson, Gordon & Co.

## Transfer Agents

First Jersey National Bank
2 Montgomery Street
Jersey City, N.J. 07303, U.S.A.

Montreal Trust Company
15 King Street West
Toronto, Ontario, Canada M5H 1B4

United California Bank
Box 3667 Terminal Annex
Los Angeles, Calif. 90051, U.S.A.

*Inquiries or requests for additional information concerning Canada Southern Petroleum Ltd. should be addressed to the Company in care of First Jersey National Bank, P.O. Box 960, Jersey City, N.J. 07303, U.S.A., or to 505 Eighth Avenue South West, Calgary, Alberta, Canada T2P 1G2.*

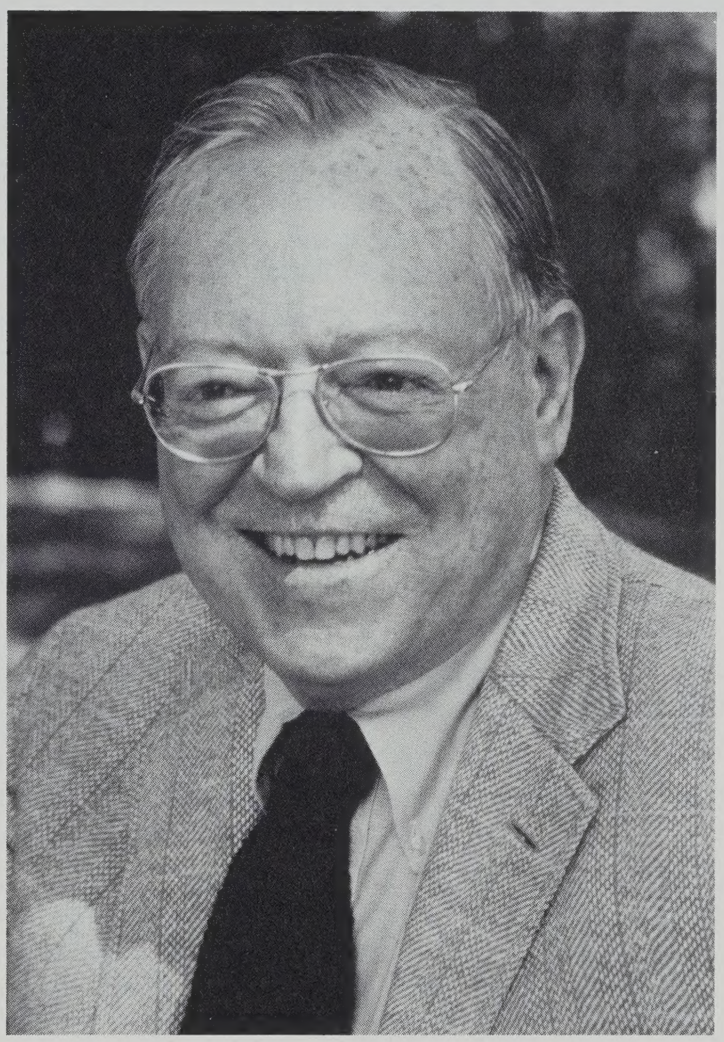
# Chairman's Message

## To the Shareholders . . .

In last year's Annual Report I categorized Canada Southern as a "Four-Phase" company, referring to the Fourth Phase as the period that will be ushered in when our large holdings in the Canadian Arctic begin to yield significant income. Recent fast-moving developments in the world's energy picture, highlighted by the marked escalation of prices for both oil and gas, now lead us to conclude that this Fourth Phase will occur much earlier than first anticipated.

There is evidence that your Company may well begin to experience significant earnings growth during the 1980's. For example, a recently completed report by D & S Consultants of Calgary, an engineering consulting firm, places your Company's share of *proven* gas reserves in the Hecla field at 16.067 billion cubic meters (567 billion cubic feet). No estimates yet have been given for the *probable* reserves of natural gas of the Hecla, Kristoffer, and Whitefish fields, which undoubtedly will prove to be substantial as the results of additional Arctic Islands' drilling become available.

This conclusion received strong support during the past year, principally as a result of the discovery of what reportedly is Canada's largest gas field at Whitefish in the High Arctic, only two and three-quarters miles north of Permit 3124 in which Canada Southern holds a 30 percent carried interest, and actually located on lands as to which your Company has "after-acquired" rights. The Whitefish discovery was made by Panarctic Oils Ltd., a consortium consisting of Petro-Canada, the Canadian national oil company, and several other oil and mining interests. Seismic and geological evidence, according to recent reports by the operator of the properties, supports a tentative and approximate reserve estimate for Whitefish of 141 billion cubic meters (5 trillion cubic feet) of gas. Significantly, the southern portion of the 20,250-hectare (50,000-acre) Whitefish structure, from the interpretation of existing seismic data, appears to extend well into the northern portion of Canada Southern's Permit 3124 (see map enclosure).



*". . . . . . Canada Southern now enjoys a sound basis for future earnings growth, and our commitment to our shareholders continues to be that of dedicating the efforts of management and staff to further enhancement of your Company's progress in the years ahead."*

I have made reference above to the Whitefish discovery well as being located on acreage as to which Canada Southern has "after-acquired" rights. By way of explanation, through its agreement with Panarctic cer-

tain of the acreage comprising Permit 1980, on which the Whitefish discovery well is located, is referred to as "after-acquired" or "common-interest" acreage, meaning that if either company, Panarctic or Canada Southern, acquires interests in certain areas subsequent to the date of their agreement, the acquiring company is obligated to offer 50 percent of such interests to the other party. Accordingly, Panarctic, which is now in the process of earning (acquiring) a 6.6 percent interest in the acreage on which the Whitefish discovery was made, will be obligated at the time of acquisition to offer one-half of such interest to Canada Southern. Notably, this "after-acquired" area, in varying interests, amounts to more than 526,500 hectares, or 1.3 million acres (areas outlined in red on the map), most of which lie within the area chosen by Panarctic for intensive future exploration.

As previously reported to shareholders, substantially all of Canada Southern's Arctic Islands' properties, approximating 2.4 million gross hectares (6.0 million gross acres), are operated by the Panarctic consortium, with Canada Southern's position consisting of carried interests in 18 separate economic units, ranging from 5 percent to 30 percent. Since entering into the agreement with this group, one gas discovery and one oil discovery have been made by Panarctic on properties in which Canada Southern holds significant interests.

Panarctic recently reported that Arctic Islands' exploration now is in transition from rank wildcat drilling throughout the islands to concerted offshore exploration in the western Sverdrup Basin, an area encompassing Canada Southern's major offshore interests. As a carried-interest partner with Panarctic in exploration work now being focused on this most prospective area of the Arctic Islands, your Company participates in this multimillion dollar project without risk to itself.

The terms of our participation are such that Canada Southern can realize its percentage share of the net proceeds from any given block's production at such time that Panarctic recoups from production, on a block-by-block basis, its exploration and development expenditures. Moreover, Canada Southern, at its option and on a block-by-block basis, reserves the right to convert from a 30 percent carried interest back to a 30 percent working interest in offshore acreage and from 5 percent to 15 percent carried interests to like working interests on onshore areas.

Prior to the Whitefish discovery, Panarctic's consultants estimated Arctic Islands' gas reserves at 360 billion cubic meters (12.7 trillion cubic feet). While this new discovery has not yet been fully evaluated, present indications are that the additional reserves attributable to it represent a major increase for the area. Further, and looking to the future, Panarctic has stated that a large number of offshore geological structures similar to Whitefish has been indicated within the western portion of the Sverdrup Basin as a result of previously completed geophysical surveys. Panarctic has plans to drill two or three of these recently identified offshore prospects during the coming winter.

Complementary applications for the marketing of Arctic Islands' gas presently are on file with Canadian regulatory authorities. These are the large-diameter pipeline project of Polar Gas Limited and the liquefied natural gas (LNG) proposal known as the Arctic Pilot Project, which is sponsored by Petro-Canada, Alberta Gas Trunk Line Company, and Melville Shipping Ltd. According to reports, the Polar Gas Project requires threshold reserves of 420 billion to 560 billion cubic meters (14.8 trillion to 19.8 trillion cubic feet), depending upon whether the project will also carry reserves from the MacKenzie Delta. The Arctic Pilot Project, requiring reserves of only 56 billion cubic meters (2 trillion cubic feet), would carry LNG gas, which would be liquefied at a plant on the southern shore of Melville Island and shipped via tankers to a terminus in eastern Canada for regasification and injection into existing pipelines.

According to present plans, pipeline construction by Polar Gas Limited would begin by the mid-1980's,

with completion toward the end of the decade. The Arctic Pilot Project, on the other hand, could commence much earlier, with production proceeding at an indicated rate of 7.1 million cubic meters (250 million cubic feet) per day. In this connection, early in August (1979) *The Wall Street Journal* carried a news release made by Petro-Canada advising that it is negotiating the sale of LNG from the Arctic Islands' fields to several gas companies in the United States, including Southern Natural Resources in Birmingham, Alabama. This refers, of course, to the Arctic Pilot Project described above. The article made reference to certain of the negotiations as being in an "advanced" stage, and a Southern Natural spokesman is quoted as saying his company would purchase "about 250 million cubic feet per day of Arctic LNG."

Elsewhere in Canada, Columbia Gas Development of Canada Ltd., operator of the Kotaneelee field, applied in April of this year to the Canadian National Energy Board for permission to export 5.8 billion cubic meters (204 billion cubic feet) of Kotaneelee gas over a 15-year period. This gas would be delivered to Columbia's parent company in the United States. Assuming approval of the export by the Energy Board, present plans call for deliveries to begin in 1980. Columbia also advised that applications for export of additional Kotaneelee reserves will be made as development of the field continues.

Production of gas from the Kotaneelee field, in which your Company holds a 30 percent carried interest, began for a limited period earlier this year upon completion of the field's dehydration plant. Capacity of the plant is 2.0 million cubic meters (70 million cubic feet) daily. Initial sales to Westcoast Transmission Company Limited on a short-term basis were at the rate of 413.4 thousand cubic meters (14.6 million cubic feet) daily. At such time as Columbia's export application is approved, and given the addition of at least one more completed well in the field, deliveries of up to 1.16 million cubic meters (41 million cubic feet) per day may be anticipated.

Apart from these major undertakings, all of which carry promise of significant growth for Canada Southern during the years ahead, the past year witnessed continued profitability, albeit at lower than expected levels due to delays at Kotaneelee and unanticipated gas and oil development programs on our British Columbia properties. In that respect, Esso Resources recently received approval from the British Columbia government for an oil development program involving the drilling of seven wells in a lower zone of the Boundary Lake field. This zone, in which Canada Southern holds a 17½ percent working interest, lies below the main oil horizon. Additionally, there have been two proposals for the drilling of gas development wells in the upper zones in which your Company's working interest also is 17½ percent.

In the Doe area of northern British Columbia, Dome Petroleum recently completed two wells as moderate gas producers on properties in which Canada Southern holds a 26.25 percent working interest. These wells are presently shut-in awaiting the extension of pipelines into the area.

It is our feeling that Canada Southern now enjoys a sound basis for future earnings growth, and our commitment to our shareholders continues to be that of dedicating the efforts of management and staff to further enhancement of your Company's progress in the years ahead.

On behalf of the Board of Directors,

John W. Buckley

John W. Buckley
*Chairman of the Board*

Calgary, Alberta
September 14, 1979

| CANADA | Gross Acreage in Which Interest is Held | Net Acreage: Held Under Lease | Net Acreage: Held Under Permit | Net Acreage: Total |
|---|---|---|---|---|
| **British Columbia** | | | | |
| Pacific Agreement | | | | |
| Working Interest | 31,212 | 5,911 | | 5,911 |
| Carried Interest | 61,971 | 13,170 | | 13,170 |
| Phillips Agreement — Carried Interest | 190,637 | 20,493 | 4,235 | 24,728 |
| Other | | | | |
| Overriding Royalty Interest | 7,278 | 563 | | 563 |
| Working Interest | 19,289 | 2,070 | 1,810 | 3,880 |
| Carried Interest | 35,808 | 1,260 | | 1,260 |
| Total British Columbia | 346,195 | 43,467 | 6,045 | 49,512 |
| **Alberta** | | | | |
| Overriding Royalty Interest | 320 | 5 | | 5 |
| **Yukon & Northwest Territories** | | | | |
| **Liard Basin** | | | | |
| Atkinson Agreement — Carried Interest | 101,166 | 22,763 | | 22,763 |
| Dome-Pan Am Agreement — Carried Interest | 62,794 | 28,258 | | 28,258 |
| Columbia Gas Agreement — Carried Interest | 73,038 | 21,911 | | 21,911 |
| Other — Working Interest | 12,720 | 11,448 | | 11,448 |
| Total Liard Basin | 249,718 | 84,380 | | 84,380 |
| **Arctic Islands** | | | | |
| Panarctic Agreements (see table, page 5) | | | | |
| TriCeeTee | 2,722,130 | 2,905 | 133,201 | 136,106 |
| Other | 3,237,814 | | 954,242 | 954,242 |
| Total Panarctic Agreements | 5,959,944 | 2,905 | 1,087,443 | 1,090,348 |
| Overriding Royalty Interest | 26,967 | | 388 | 388 |
| B.P. Sub-Farmout | 58,659 | | 19,843 | 19,843 |
| Total Arctic Islands | 6,045,570 | 2,905 | 1,107,674 | 1,110,579 |
| Total Canada | 6,641,803 | 130,757 | 1,113,719 | 1,244,476 |
| AUSTRALIA | 76,800 | | 3,840 | 3,840 |
| Grand Total | 6,718,603 | 130,757 | 1,117,559 | 1,248,316 |

## COMPANY-INTEREST PROPERTIES IN PANARCTIC AGREEMENTS — JULY 31, 1979

| Properties | Gross Acres | Interest retained by Company: Carried Interest | Interest retained by Company: Net Acres |
|---|---|---|---|
| **TriCeeTee Agreement** | | | |
| Prince Patrick, Melville, Emerald, Vanier, Cameron, Ellef Ringnes, Cornwall | 2,722,130 | 5.0%[1] | 136,106 |
| **Canada Southern-Clark-Skelly Agreement** | | | |
| Eight Bears | 57,210 | 6.0% | 3,433 |
| **Canada Southern** | | | |
| Ellesmere | 22,482 | 15.0% | 3,372 |
| Offshore, Sverdrup Basin | 3,158,122 | 30.0%[2] | 947,437 |
| | 5,959,944 | | 1,090,348 |

[1] Does not include the Company's additional interest to be acquired under the sub-farmout agreement covering permits on Vanier Island.

[2] Area divided into six blocks, each converted to 30.0% carried interest, which may be reconverted to 30.0% working interest at the Company's option.

## STATUS OF CARRIED-INTEREST AGREEMENTS AS AT JUNE 30, 1979

**(excluding Panarctic agreements)**

| | 1978 Gross Expenditures | 1978 Production Proceeds | 1979 Gross Expenditures | 1979 Production Proceeds | Cumulative to June 30, 1979 Gross Expenditures | Cumulative to June 30, 1979 Production Proceeds | Cumulative to June 30, 1979 Net Expenditures | Company Interest % | Company Interest Cost to Convert to Working Interest |
|---|---|---|---|---|---|---|---|---|---|
| **Pacific Agreements** | | | | | | | | | |
| Ex-Permits 100-104 | $ 364,084 | $4,263,260 | $ 1,021,521 | $2,514,119 | $19,512,877 | $23,291,678 | $ (3,778,861) | 21.25 | * |
| Ex-Permit 135 | 186,100 | 1,356,580 | 104,479 | 1,218,396 | 7,823,287 | 10,798,698 | (2,975,411) | 1.67 | ** |
| **Phillips Agreement** | | | | | | | | | |
| Ex. P. 149 | 207,224 | (36,528) | 53,842 | (2,652) | 5,867,758 | 231,138 | 5,636,620 | 50.00 | $2,818,310 |
| Ex. P. 178 | 284,974 | 1,419,507 | 55,554 | 1,739,467 | 3,497,561 | 8,171,522 | (4,873,961) | 27.75 | *** |
| Ex. P. 224 | 638,484 | 3,203,266 | 140,709 | 2,622,486 | 7,817,244 | 20,807,217 | (12,989,973) | 27.75 | **** |
| **Dome Pan-American Agreement** | | | | | | | | | |
| Ex. Ps. 1007,1132,1133 | 10,230,208 | | 13,950,198 | | 27,970,892 | | 27,970,892 | 30.0 | 8,391,268 |
| Ex. Ps. 1136,2713,1153 | 27,930 | | 27,930 | | 630,472 | | 630,472 | 45.0 | 283,712 |
| Ex. Ps. 1149, 1156 | 13,451 | | 13,452 | | 1,168,335 | | 1,168,335 | 45.0 | 525,751 |

* Ex-Permits 100-104 net proceeds from production became payable to the Company in March 1978, and by June 30, 1979 the Company's share amounted to $802,995, including $485,818 in fiscal 1978 and $317,177 in fiscal 1979.

** Ex-Permit 135 net proceeds from production became payable to the Company in January 1977, and by June 30, 1979 the Company's share amounted to $49,591, including $19,508 in fiscal 1978 and $18,566 in fiscal 1979.

*** Ex-Permit 178 net proceeds from production became payable to the Company in July 1970, and by June 30, 1979 the Company's share amounted to $1,343,502, including $326,620 in fiscal 1978 and $456,040 in fiscal 1979.

**** Ex-Permit 224 net proceeds from production became payable to the Company in December 1968, and by June 30, 1979 the Company's share amounted to $3,581,863, including $738,277 in fiscal 1978 and $673,684 in fiscal 1979.

# Consolidated Balance Sheets

(Expressed in Canadian dollars)
*June 30, 1979 and 1978*

| **Assets** | **1979** | **1978** |
|---|---|---|
| Current assets: | | |
| Cash | $ 99,709 | $ 84,122 |
| Term deposits | 734,975 | 324,975 |
| Accounts receivable and other current assets | 332,054 | 735,351 |
| Total current assets | 1,166,738 | 1,144,448 |
| Oil and gas properties, at cost less accumulated depletion of $1,392,717 and $1,156,007 at June 30, 1979 and 1978, respectively (Notes 1 and 3) | 8,156,705 | 7,658,769 |
| Mineral properties, at cost (Notes 1 and 3) | 232,370 | 427,062 |
| Equipment, at cost less accumulated depreciation of $46,047 and $38,244 at June 30, 1979 and 1978, respectively | 21,806 | 20,840 |
| Deferred charge | 87,302 | — |
| | $ 9,664,921 | $9,251,119 |
| **Liabilities and Capital** | | |
| Current liabilities: | | |
| Bank loan payable | $ — | $ 144,000 |
| Accounts payable and accrued liabilities: | | |
| The Catawba Corporation (Note 4) | — | 37,498 |
| Accrued legal | 53,624 | 23,477 |
| Other | 292,002 | 109,474 |
| Total current liabilities | 345,626 | 314,449 |
| Bank loan payable, less current portion included above | — | 248,000 |
| Capital (Note 5): | | |
| Capital stock, par value $1 per share: | | |
| Authorized 15,000,000 shares | | |
| Outstanding 8,883,465 and 8,851,465 shares, respectively | 8,883,465 | 8,851,465 |
| Capital in excess of par value | 14,562,294 | 14,456,694 |
| | 23,445,759 | 23,308,159 |
| Accumulated deficit | (14,126,464) | (14,619,489) |
| | 9,319,295 | 8,688,670 |
| | $ 9,664,921 | $ 9,251,119 |

*See accompanying notes.*

On behalf of the Board:
/s/ John W. Buckley, *Director*
/s/ Benjamin W. Heath, *Director*

Canada Southern Petroleum Ltd. (A Canadian corporation)

# Consolidated Statement of Operations and Accumulated Deficit (Note 1)

(Expressed in Canadian dollars)

| | Year ended June 30, 1975 | 1976 | 1977 | 1978 | 1979 |
|---|---|---|---|---|---|
| Income: | | | | | |
| Proceeds under carried interest agreements (Note 3) | $ 271,743 | $ 241,430 | $ 233,582 | $ 1,549,293 | $ 1,468,691 |
| Interest | 73,666 | 28,430 | 13,999 | 16,145 | 56,303 |
| Oil and gas sales | 85,121 | 75,785 | 144,693 | 309,404 | 223,903 |
| Gains and (losses) on sales of equipment and properties | — | 335,583 | (1,390) | — | — |
| Rent and other | 35,987 | 27,757 | 413 | — | — |
| | 466,517 | 708,985 | 391,297 | 1,874,842 | 1,748,897 |
| Costs and expenses: | | | | | |
| General and administrative (Notes 4 and 6) | 577,029 | 763,253 | 640,998 | 713,478 | 745,603 |
| Abandonments (Note 3) | 30,156 | 223,891 | 55 | — | 203,702 |
| Depletion, depreciation and amortization | 141,545 | 107,105 | 130,937 | 166,548 | 244,514 |
| Lease operating costs | 18,892 | 22,220 | 28,447 | 19,258 | 36,478 |
| Write-off of investments | 377 | 143,947 | 310,224 | 2,154 | (15,994) |
| Rent | 18,428 | 23,393 | 29,078 | 34,987 | 41,569 |
| | 786,427 | 1,283,809 | 1,139,739 | 936,425 | 1,255,872 |
| Income (loss) before taxes on income and extraordinary item | (319,910) | (574,824) | (748,442) | 938,417 | 493,025 |
| Provision for taxes on income (Note 7) | — | — | — | 291,000 | 262,000 |
| Income (loss) before extraordinary item | (319,910) | (574,824) | (748,442) | 647,417 | 231,025 |
| Tax benefit realized from carryforward of exploration, development and lease acquisition costs not claimed in prior years (Note 7) | — | — | — | 291,000 | 262,000 |
| Net income (loss) | (319,910) | (574,824) | (748,442) | 938,417 | 493,025 |
| Accumulated deficit—beginning of year | (13,914,730) | (14,234,640) | (14,809,464) | (15,557,906) | (14,619,489) |
| Accumulated deficit—end of year | $(14,234,640) | $(14,809,464) | $(15,557,906) | $(14,619,489) | $(14,126,464) |
| Average number of shares outstanding | 8,764,965 | 8,764,965 | 8,810,273 | 8,851,465 | 8,873,619 |
| Per share based on average number of shares outstanding during the period: | | | | | |
| Income (loss) before extraordinary item | $(.04) | $(.07) | $(.08) | $.08 | $.03 |
| Extraordinary item | — | — | — | .03 | .03 |
| Net income (loss) | $(.04) | $(.07) | $(.08) | $.11 | $.06 |

*See accompanying notes.*

# Consolidated Statement of Changes in Financial Position

(Expressed in Canadian dollars)

| | Year ended June 30, | | | | |
|---|---|---|---|---|---|
| | 1975 | 1976 | 1977 | 1978 | 1979 |
| Source of working capital: | | | | | |
| Net income (loss) | $ (319,910) | $ (574,824) | $ (748,442) | $ 938,417 | $ 493,025 |
| Charges (credits) to revenues not involving outlay of working capital in current periods: | | | | | |
| Depreciation, depletion and amortization | 141,545 | 107,105 | 130,937 | 166,548 | 244,514 |
| Write-off of investments | 377 | 142,769 | 308,999 | — | — |
| Abandonments | 30,156 | 223,891 | — | — | 200,211 |
| Gains and losses on sales of equipment and properties | — | (335,583) | 1,390 | — | — |
| Working capital (used in) provided by operations | (147,832) | (436,642) | (307,116) | 1,104,965 | 937,750 |
| Net proceeds from sales of capital stock | — | — | 177,454 | — | — |
| Exercise of stock options | — | — | — | — | 137,600 |
| Proceeds from sales of equipment or properties | 10,000 | 588,765 | 281 | 115,000 | — |
| Bank loan | — | — | 392,000 | — | — |
| | (137,832) | 152,123 | 262,619 | 1,219,965 | 1,075,350 |
| Disposition of working capital: | | | | | |
| Additions to oil, gas and mineral properties | 662,640 | 300,666 | 303,556 | 366,932 | 740,167 |
| Increase in investments | 5,579 | 10,204 | 16,625 | — | — |
| Expenses of capital stock offerings | 26,416 | 103,616 | — | — | — |
| Decrease in bank loan (noncurrent) | — | — | — | 144,000 | 248,000 |
| Deferred charge | — | — | — | — | 87,302 |
| Other | 65 | 8,091 | 329 | 15,982 | 8,769 |
| | 694,700 | 422,577 | 320,510 | 526,914 | 1,084,238 |
| Increase (decrease) in working capital | $ (832,532) | $ (270,454) | $ (57,891) | $ 693,051 | $ (8,888) |
| Increase (decrease) in working capital by component: | | | | | |
| Cash | $ 12,607 | $ (8,168) | $ (28,396) | $ 61,383 | $ 15,587 |
| Term deposits | (755,000) | (310,025) | 100,000 | 30,000 | 410,000 |
| Accounts receivable and other current assets | (43,754) | 10,205 | 42,829 | 602,803 | (403,297) |
| Bank loan payable | — | — | (99,688) | (36,000) | 144,000 |
| Accounts payable and accrued liabilities | (46,385) | 37,534 | (72,636) | 34,865 | (175,178) |
| Increase (decrease) in working capital | $ (832,532) | $ (270,454) | $ (57,891) | $ 693,051 | $ (8,888) |

*See accompanying notes.*

## Consolidated Statement of Capital Stock and Capital in Excess of Par Value

(Expressed in Canadian dollars) *Years ended June 30, 1978 and 1979*

| | Number of shares | Capital stock, $1 par value | Capital in excess of par value | Total |
|---|---|---|---|---|
| Balance at June 30, 1977 and 1978 .... | 8,851,465 | $8,851,465 | $14,456,694 | $23,308,159 |
| Exercise of stock options ......... | 32,000 | 32,000 | 105,600 | 137,600 |
| Balance at June 30, 1979 ............. | 8,883,465 | $8,883,465 | $14,562,294 | $23,445,759 |

*See accompanying notes.*

## Notes to Financial Statements

*June 30, 1979*

### 1. Summary of significant accounting policies and current developments

The accompanying consolidated financial statements include the accounts of Canada Southern Petroleum Ltd. (Canada Southern) and its wholly-owned subsidiary, Canpet, Inc., hereafter referred to collectively as the Company.

The Company, which is engaged in only one industry, exploration for and development of oil and gas properties, principally in Canada, follows the full cost method of accounting for oil and gas properties, whereby all costs associated with the exploration for and the development of oil and gas reserves are capitalized. Proceeds received from disposal of properties are credited against accumulated costs. Depletion on net costs accumulated in the Canada cost center (excluding the Arctic Islands and Kotaneelee Field) is provided on the composite unit-of-production method based on estimated recoverable proven reserves. Expenditures incurred in the Arctic Islands, Kotaneelee Field and Australia are being deferred pending the results of exploration in progress or commencement of production. These costs will be depleted by cost center on the basis of reserves discovered or written off to income if exploration activities prove unsuccessful.

Properties abandoned prior to July 1, 1974 were not capitalized as the resulting total cost of the properties would have exceeded their estimated value at that date.

The Securities and Exchange Commission (SEC) has recommended development of an accounting method that recognizes valuations of proved oil and gas reserves in the balance sheets and income statements of oil and gas producers. Until the new method, Reserve Recognition Accounting (RRA), is developed, for fiscal years ending after December 25, 1979, the SEC will allow either successful efforts accounting as prescribed by Statement of Financial Accounting Standards (SFAS) No. 19 or a form of full cost accounting as prescribed by the SEC. The Company's present accounting policies are substantially in agreement with the form of full cost accounting prescribed by the SEC so that a change to the SEC form of full cost accounting would have no significant effect on the financial position or results of operations of the Company. Certain other disclosures will be required in the financial statements such as information concerning estimated future net revenue from proved oil and gas reserves. According to the SEC, "The feasibility of RRA, however, is not assured, because of the inherent imprecision of reserve valuations and, therefore, the ultimate method of reporting is not yet determinable."

Acquisition costs, exploration and development expenditures and other costs related to mineral properties are capitalized until such time as it is determined whether commercially exploitable reserves exist. Costs associated with properties which are determined to be unsuccessful or abandoned are charged to income. Costs associated with commercially exploitable prospects will be amortized or depreciated on a unit-of-production method.

Depreciation has been provided for equipment other than well equipment by the straight-line method based on estimated useful lives. Depreciation of well equipment and amortization of intangible drilling costs pertaining to producing wells are computed by the unit-of-production method.

Transactions for settlement in U.S. dollars have been converted at average monthly exchange rates. During the five years ended June 30, 1979, exchange gains and losses have not been significant.

For Canadian income tax purposes, the Company may claim as a tax deduction exploration, development and lease acquisition costs in the year incurred, and capital cost allowances (depreciation) in amounts which may exceed those provided in the accounts (see Note 7).

The Securities and Exchange Commission issued an order dated April 11, 1978 directing that an examination and private investigation by the Staff of the Commission be made of the Company, the Catawba Corporation ("Catawba") (see Note 4) and Catawba's other client companies. The Commission has expressed interest in investigating, among other things, the Australian hydrocarbon reserves of the various companies, the relationship between those companies and Catawba and the fees and royalties paid by them to Catawba to determine whether possible violations of the Securities Exchange Act of 1934 and/or the Investment Company Act of 1940 may have

occurred. During fiscal 1979 the Company furnished certain documents requested by the Staff of the Commission. The Company is cooperating fully with the Commission in providing whatever information may be required and believes it has committed no violations.

### 2. Investments and advances

Under an agreement dated March 6, 1979, the Company exchanged shares and debentures of Borealis Exploration Limited (Borealis) and working interests in certain mineral properties operated by Borealis for overriding royalty interests in properties on Melville Peninsula and Baffin Island in northern Canada. The Company had written down its investment in Borealis to a nominal value of $1 at June 30, 1977; accordingly, the overriding royalty interests are carried at $1 in the accompanying consolidated balance sheet.

### 3. Properties and related exploratory and other expenses

Net oil, gas and mineral properties by cost center are as follows:

| | 1979 | 1978 |
|---|---|---|
| Oil and gas properties: | | |
| Canada | $3,968,219 | $3,521,957 |
| Arctic Islands | 2,940,630 | 2,889,341 |
| Kotaneelee Field | 1,119,828 | 1,119,443 |
| | 8,028,677 | 7,530,741 |
| Australia | 128,028 | 128,028 |
| | 8,156,705 | 7,658,769 |
| Mineral properties | 232,370 | 427,062 |
| | $8,389,075 | $8,085,831 |

Current valuations of proved reserves and other discoveries exceed related book value plus expected development costs.

Amounts represented by oil and gas properties and mineral properties, aggregating $3,301,028 and $3,444,431 at June 30, 1979 and 1978, respectively, are substantially unexplored or underdeveloped.

The Company's properties and property interests are located in British Columbia, the Yukon and Northwest Territories, the Arctic Islands and Alberta in Canada and in Australia.

At June 30, 1979, substantially all of the acreage located in British Columbia and the Yukon and Northwest Territories was covered by carried (net profits) interest agreements. These carried interest agreements provide that profits are not payable to the Company until expenditures by the operators have been recouped from production. Also, the Company may at any time elect to convert its position from a carried interest to a working interest by paying its share of the expenditures not recouped by profits from production. At June 30, 1979 and 1978, the accumulated expenditures by the operators attributable to all of the Company's carried interests in these areas exceeded the amounts recouped from production by approximately $10,800,000 and $3,500,000, respectively. Two blocks, in which the Company's interest is 27.75%, have reached payout status. The Company's share of profits from these blocks was $271,743, $241,430, $222,065, $1,043,967 and $1,129,724 for the five years ended June 30, 1979, which amounts have been credited to income. In fiscal 1979 and 1978, the Company received income of $338,967 and $505,326, respectively, from other carried interests. Of the 1978 amount, approximately $355,000 related to recoveries of tax credits (in the fourth quarter) arising from exploration expenditures; approximately $254,000 of this amount relates to prior years and is nonrecurring.

The Company has a 30% carried interest in the Kotaneelee Field in the Yukon Territory. Three wells have been completed and a fourth is presently drilling. The original discovery well was drilled in 1964 and required a significant amount of rework, which was recently completed. In February and March 1979, a small amount of gas was produced from this field. The operator of the Kotaneelee Field has made an application to the Canadian National Energy Board which, if granted, would allow the export of a maximum of 204 billion cubic feet of gas during a fifteen year period beginning January 1, 1980.

Most of the Company's interests in the Arctic Islands are subject to carried interest agreements with Panarctic Oils Ltd. The Company's carried interests range from 5% to 30%.

### 4. The Catawba Corporation

For the five years ended June 30, 1979, the Company was charged $227,004, $362,320, $309,171, $300,069 and $381 for financial, technical and other services rendered by Catawba. By virtue of Catawba's contracts with Canada Southern and the services Catawba performed pursuant thereto, and the fact that certain officers and directors of Canada Southern were also officers, directors or shareholders of Catawba, Catawba may have been deemed a "parent" of and to "control" Canada Southern, as such terms are defined in the Securities Act of 1933, as amended. By agreement between Canada Southern and Catawba dated May 10, 1978, the parties agreed to terminate as of May 31, 1978 their contract dated as of August 1, 1973. Certain of the directors, officers and employees of Catawba who were also directors or officers of Canada Southern have severed their relationships with Catawba. In view of the termination of the Catawba contract and the severing of these relationships, the Company believes that the statement that Catawba may be "deemed to be a 'parent' of and to 'control' Canada Southern" is no longer applicable.

## 5. Capital and stock options

Stock options outstanding at June 30, 1979 are summarized as follows:

| Optionee | Date of grant | Expiration date | Number of shares | Option price | | Market price at date of grant | |
|---|---|---|---|---|---|---|---|
| | | | | Per share | Aggregate | Per share | Aggregate |
| Officers and director | Oct. 7, 1977 | Oct. 6, 1982 | 20,000 | $4.30 | $ 86,000 | $4.30 | $ 86,000 |
| Employees | Oct. 7, 1977 | Oct. 6, 1982 | 2,500 | 4.30 | 10,750 | 4.30 | 10,750 |
| Officers and director | May 11, 1979 | May 10, 1984 | 86,500 | 5.00 | 432,500 | 5.00 | 432,500 |
| Employees | May 11, 1979 | May 10, 1984 | 7,500 | 5.00 | 37,500 | 5.00 | 37,500 |
| | | | 116,500 | | $566,750 | | $566,750 |

The options granted October 7, 1977 were granted under an incentive option plan on 300,000 shares of Canada Southern's capital stock adopted by the Board of Directors on September 21, 1973 and the options granted May 11, 1979 were granted under a new incentive option plan on 300,000 shares adopted by the Board of Directors on December 13, 1978. All options were exercisable on the date of grant. There were 206,000 and 68,500 shares reserved for future option grants at June 30, 1979 and 1978, respectively. In August 1978, as a result of the termination of the Catawba contract (see Note 4), options on 150,000 shares granted to Catawba expired and on November 20, 1978, options on 27,000 shares granted to officers and employees expired without exercise. In October 1978, a director exercised an option on 32,000 shares at $4.30 per share, an aggregate of $137,600; at that time, the average market price was $5.90 per share, an aggregate of $188,886. There were no other changes in stock options during the two years ended June 30, 1979.

Upon exercise of options, the excess of the proceeds over the par value of the shares issued is credited to capital in excess of par value. No charges are made against income in accounting for options.

The letters patent, as supplemented, of the Company provide that no person (as defined) shall vote more than 1,000 shares.

No dividends were paid during the five years ended June 30, 1979.

## 6. Compensation

The Company has a contributory pension plan which is in effect for all employees and is administered by an insurance company. Benefits payable on retirement to employees are guaranteed by annuities purchased by the insurance company. The Company's policy is to fund pension cost accrued, except that total prior service cost for the plan was prepaid in 1979. Contributions by the Company to the pension plan on behalf of all employees were $13,015, $11,759, $29,075, $33,274 and $33,957 for the five years ended June 30, 1979.

Compensation of directors, officers and senior employees allocated to or paid directly by Canada Southern, including contributions to a pension plan on their behalf, amounted to $184,168 and $276,134 for the years ended June 30, 1978 and 1979, respectively. Of these amounts, $54,455 and $84,519 were on behalf of directors and $129,713 and $191,615 were on behalf of officers. At June 30, 1979, there were five directors and five officers, of which one was also a director.

## 7. Income taxes and extraordinary item

The amount of income tax expense for fiscal 1978 is lower than the amount computed by multiplying pretax income by the statutory Canadian rate of 46% due to statutory deductions for depletion and resource allowances. The amount of income tax expense for fiscal 1979 is higher than the amount computed by multiplying pretax income by the statutory Canadian rate of 46% due to non-deductible mineral costs which were charged to abandonments for financial reporting purposes. This was partially offset by statutory deductions for depletion and resource allowances.

For the years ended June 30, 1978 and 1979, the Company realized tax benefits of $291,000 and $262,000, respectively, for Canadian income tax purposes from carryforward of exploration, development and lease acquisition costs not claimed in prior years. For the five years ended June 30, 1979, the Company had no Canadian income tax liability and at June 30, 1979, the following amounts remained to be carried forward indefinitely to reduce future taxable income:

| | |
|---|---|
| Drilling, exploration and lease acquisition costs ... | $13,400,000 |
| Undepreciated capital costs .................... | 700,000 |
| Capital losses (can only be used against future years' capital gains) ........................ | 150,000 |

The tax benefits attributable to the above accumulated expenditures will not be reflected in the financial statements until such benefits are realized.

## Report of Independent Public Accountants

*The Shareholders*

**Canada Southern Petroleum Ltd.**

We have examined the accompanying consolidated balance sheets of Canada Southern Petroleum Ltd. at June 30, 1979 and 1978 and the related consolidated statements of operations and accumulated deficit and consolidated changes in financial position for each of the five years in the period ended June 30, 1979 and of capital stock and capital in excess of par value for the two years ended June 30, 1979. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements mentioned above present fairly the consolidated financial position of Canada Southern Petroleum Ltd. at June 30, 1979 and 1978, the consolidated results of operations and the consolidated changes in financial position for each of the five years in the period ended June 30, 1979 and the consolidated changes in capital stock and capital in excess of par value for the years ended June 30, 1979 and 1978, in conformity with generally accepted accounting principles applied on a consistent basis during the period.

ARTHUR YOUNG, CLARKSON, GORDON & CO.

Hartford, Connecticut
August 28, 1979

## Supplementary and Market Information

The present year marks the 25th Anniversary of the incorporation of Canada Southern Petroleum Ltd. The Company was incorporated in 1954 under the Canada Corporations Act as a result of a plan of reorganization of a predecessor company, Canada Southern Oils, Inc.

The Company is engaged in the exploration and development of properties containing or believed to contain recoverable hydrocarbon reserves and mineral deposits. At present, a major portion of these properties is undeveloped. Substantially all of the acreage held by the Company is covered by carried-interest agreements, which provide that profits are not payable to the Company until expenditures by the operators have been recouped from production. The Company may, at any time, elect to convert its position from a carried position to a working-interest position by paying its share of the expenditures not recouped by profits from production.

The Company's shares of capital stock are listed and traded under the symbol "CSW" on the Toronto and Montreal stock exchanges in Canada and on the Pacific and Boston stock exchanges in the United States. The Company's shares are also traded under the symbol "CSPEF" in the NASDAQ over-the-counter market.

The total sales volume on the Pacific Stock Exchange for the years 1977 and 1978 amounted to 919,808 shares and 1,708,558 shares, respectively, and a quarterly price range for such shares during 1978 and 1979 follows (prices expressed in U.S. dollars):

| 1978 | 1st quarter | 2nd quarter | 3rd quarter | 4th quarter |
|---|---|---|---|---|
| High | 5 7/16 | 5 | 6 1/2 | 5 7/8 |
| Low | 3 11/16 | 3 3/4 | 4 5/16 | 4 |

| 1979 | 1st quarter | 2nd quarter | *3rd quarter |
|---|---|---|---|
| High | 4 15/16 | 6 1/8 | 6 13/16 |
| Low | 4 | 4 1/8 | 4 15/16 |

*through July 31

The total sales volume on the Toronto Stock Exchange for the years 1977 and 1978 amounted to 7,383,200 shares and 6,377,018 shares, respectively, and a quarterly price range for such shares during 1978 and 1979 follows (prices expressed in Canadian dollars):

| 1978 | 1st quarter | 2nd quarter | 3rd quarter | 4th quarter |
|---|---|---|---|---|
| High | 5.87 | 5.62 | 7.12 | 6.75 |
| Low | 4.20 | 4.35 | 4.85 | 4.80 |

| 1979 | 1st quarter | 2nd quarter | *3rd quarter |
|---|---|---|---|
| High | 5.87 | 7.00 | 7.12 |
| Low | 4.95 | 5.00 | 5.62 |

*through July 31

## Management's Discussion and Analysis

### 1979 vs 1978

The Company recorded its second profitable year in a row in 1979, although revenues were down slightly because oil and gas sales and carried-interest proceeds were adversely affected by weak demand and refinery shutdowns early in the year. Interest income rose as the amount invested in time deposits increased.

Increases in general and administrative expenses related to salaries and employee benefits as well as to legal and stockholders' expenses. Lease operating costs in 1979 increased due to inflationary pressures. The Company in the same year made a partial recovery relating to an investment in a project previously written off. The abandonments in 1979 included a mineral project in Saskatchewan. Depletion, depreciation, and amortization was higher in 1979 as higher cost priorities were added to the amortization base. The Company pays no income taxes because of the carryforward of exploration, development, and lease acquisition costs not claimed in prior years.

### 1978 vs 1977

The Company recorded its first profitable year in fiscal 1978 as a result of a very significant increase in proceeds under carried-interest agreements. A portion of the increase, estimated at $254,000, related to recoveries of tax credits arising from exploration expenditures in prior years and is nonrecurring. However, the balance of the increase reflects improvements as carried interests benefit from capital expenditures in other years and as prices improve. Oil and gas sales in 1978 also benefited from higher unit sales and improved prices.

General and administrative expenses were higher in 1978, primarily because of increased salaries and legal expenses. Depletion, depreciation, and amortization charges increased in 1978 with increased production.

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